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Testimony

Statement
of
Robert J. Lieberman
Deputy Inspector General
of the
Department of Defense
to the
Subcommittee on National Security,
Veterans Affairs, and International Relations
House Government Reform Committee
on
Transforming Defense Financial Management:
A Strategy for Change

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Mr. Chairman and Members of the Committee:

Thank you for the opportunity to provide the views of the Office of the Inspector General of the Department of Defense on transforming financial management, which surely ranks as one of the Department's most difficult management improvement challenges. I would like to begin by noting the fundamental fiduciary responsibility of the Department of Defense, which is to manage assets purchased with taxpayer dollars effectively and efficiently. Furthermore, Article I, Section 9 of the Constitution of the United States stipulates that "a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." As you know from your numerous hearings on DoD financial management, the Department has had long-standing problems in compiling accurate financial statements.

The Need for Transformation

The Federal Government and Department of Defense have had numerous financial management improvement plans, programs, and goals over the past 50 years. Perhaps it appears ironic today, but in the 1960's the Department was the leader in adapting new financial management concepts for government agencies. Its Planning, Programming and Budgeting System was widely emulated and it led the way in computerizing large payroll, contractor payment and accounting operations during the 1960's and 70's. Unfortunately, the uncontrolled proliferation of nonstandard systems for performing both financial and nonfinancial functions in DoD created a host of problems that now plague managers. Those problems include a lack of integrated information systems that can consistently produce either useful day-to-day fiscal information or commercial type financial statements on a quarterly, semiannual or even annual basis. The limited capabilities of current systems create and perpetuate inefficiencies across the spectrum of DoD business activities.

The Chief Financial Officers Act of 1990 and related legislation brought the financial reporting problems of most Federal agencies, including DoD, to light by requiring Inspector General audits of year-end financial statements. For over a decade, the Office of the Inspector General of the DoD has reported that the lack of adequate financial reporting systems and a variety of internal control problems preclude favorable audit opinions on most DoD year-end financial statements.

Opinions on Financial Statements for FY 2001

In terms of audit opinions on the reliability of DoD's most recent financial statements, I am unable to report progress for the DoD-wide or major component funds. As in previous years, we issued an unqualified (clean) opinion this year for the Military Retirement Fund's statements. Disclaimers of opinion were necessary for all other major funds, however, because of serious deficiencies in the reporting systems and other internal control problems. A few DoD organizations, whose funds are not large enough to require separate reporting to OMB, have achieved favorable audit opinions, but the impact is primarily symbolic.

Other Recent Audit Results

Although the annual audit opinions on year-end financial statements may continue to attract more attention than most individual audit reports, the DoD progress in addressing the specific findings and recommendations in those reports will be a critical factor in how much financial management improvement actually occurs, especially in crucial day-to-day activities like paying bills and collecting debts.

The variety of recent audit findings illustrates the breadth of the DoD financial management challenge.

-- We reported in May 2001 that the Defense Finance and Accounting Service needed to be more efficient and aggressive in collecting debt from large contractors. We identified 148 cases worth \$12.6 million where action was needed. The List of Contractors Indebted to the United States, which is a tool used by disbursing officers to offset contractor debts, included numerous invalid debts and other erroneous data that reduced its usefulness. (Report D-2001-114)

-- In June 2001, we reported that DoD had successfully adapted a commercial automated payment system for DoD freight payment purposes. This enabled the Department to move away from untimely, paper-based, poorly controlled and labor intensive processes for 1.25 million payments per year. However, additional measures were warranted to take full advantage of the system's capabilities and achieve optimum streamlining without undue risk of fraud or error. (Report D-2001-148)

-- In August 2001, we reported that the DoD had failed to develop a standardized cost accounting system for managing the life cycle costs of weapon systems. DoD reports that various acquisition reform goals had been met by establishing such a system were wrong. (Report D-2001-164)

-- The DoD agreed with Congress in August 1998 to implement a new policy to decrease the risk of progress payments being charged to the wrong accounts. We reported in September 2001 that implementation had been poorly managed and the new policy was ineffectual. (Report D-2001-188)

-- We reported in November 2001 that DoD financial management systems were not integrated and could not share data without expensive and inefficient crosswalks. Nevertheless, the Department had been moving ahead with the Defense Finance and Accounting Service Corporate Database and other projects, with insufficient assurance that a truly integrated set of systems would result. (Report D-2002-014)

-- The DoD plans to begin the transition from the existing contractor payment system, the archaic Mechanization of Contract Administration Services (MOCAS) system, to the new Defense Procurement Payment System by FY 2003. Full transition should bring significant improvement to DoD contract administration and disbursement activities. To ensure a smooth transition, it is important to close as many contracts that have been completed, but not closed out, as possible. In December 2001, we reported that DoD had a six year backlog of contract closure actions and needed to accelerate the process. In addition, there were weaknesses in the closure procedures, insufficient resources earmarked for the task and untimely contractor input. Cumulatively, these problems increased the risk to an orderly transition. (Report D-2002-027)

-- From FY 1996 through FY 2001, 382 General Accounting Office and DoD audit reports addressed a wide range of management control issues in the DoD Purchase Card Program. The Army and Air Force had particularly thorough internal audit coverage. Those audit results were summarized in a December 2001 Inspector General, DoD, report. Auditors documented numerous instances of misuse of the cards, lack of oversight and accountability, splitting purchases to avoid oversight, failure to segregate duties and inadequate training. (Report D-2002-029)

-- In January 2002, we reported that most DoD components initially had done little to implement the DoD Financial and Feeder Systems Compliance Process, which had been recommended by us in 1999 and was finally inaugurated by the Department in January 2001, to apply the proven management techniques of the Year 2000 conversion program to financial systems improvement. Progress in mapping the flow of financial data and compiling an inventory of systems had been disappointingly slow, despite the fact that such research was supposed to have been done earlier for a variety of reasons, including identification of security vulnerabilities, contingency planning, and systems architecture development. However, major new DoD management initiatives during FY 2001 and the guidance provided by the National Defense Authorization Act for FY 2002 had established the groundwork for a more successful effort. (Report D-2002-044)

-- In March 2002, we reported that the two versions of the Computerized Accounts Payable System, used for Army and Defense agency payments, lacked effective controls to detect and correct improperly supported or erroneous payments to contractors. (Report D-2002-056)

-- In March 2002, we issued two more reports on the use of Government credit cards. The first was a summary of 31 DoD internal audit reports on the DoD Travel Card Program. A wide range of problems, similar to those in the DoD Purchase Card Program, were identified. The report recounts the actions taken by the Under Secretary of Defense (Acquisition, Technology and Logistics) and the Under Secretary of Defense (Comptroller) between June 2001 and early March 2002 to strengthen both the Travel Card and Purchase Card Programs. (Report D-2002-065)

-- The second report on credit cards addressed ways to improve controls in the DoD Purchase Card Program. This report also recounts recent DoD activities to minimize abuse of Government credit card privileges, including new initiatives announced in late March by the Under Secretary of Defense (Comptroller). (Report D-2002-075)

-- We reported last year that DoD personnel offices lacked efficient procedures for transmitting employee elections on payroll withholding to the finance offices and kept poor records. The error rate for insurance and retirement withholdings and agency contributions was

approximately 9 percent. In March 2002, we reported the same problems were persisting and the estimated error rate remained about 9 percent. (Report D-2002-070)

-- In March 2002, we reported that DoD needed to improve its procedures for tracking and collecting recoupments from foreign governments under the NATO Security Investment Program. Specifically, more aggressive action was needed to collect \$38.6 million owed by various countries after the U.S. provided upfront financing for construction projects. (Report D-2002-071)

-- In a second report on contract closure efforts related to the phase out of the MOCAS system, we reported in March 2002 on problems with old contracts that were financed from now cancelled appropriations. Nearly 4,000 of those contracts could not be closed because of unpaid invoices. Various DoD organizations had not identified funding to make the payments and prompt payment interest penalties were being incurred. The Department needs to identify up to \$97 million in current year funds to pay these bills. (Report D-2002-076)

The full text of these reports is available on-line at www.dodig.osd.mil.

Responding to Congressional Direction

Section 1008 of the National Defense Authorization Act for FY 2002 directs the Inspector General, DoD, to perform only the minimum audit procedures required by auditing standards for year-end financial statements that management acknowledges to be unreliable. The Act also directs us to redirect any audit resources freed up by that limitation to more useful audits, especially in the financial systems improvement area.

We strongly agree with the rationale behind Section 1008. Due to overall resource constraints, it would be impossible to provide audit support in the crucial systems improvement area if we were forced to continue expending resources on labor-intensive audits of convoluted workarounds and poorly documented transactions that currently characterize most major DoD financial statements. We have long advocated focusing primary attention on the system problems that are at the core of the DoD financial reporting problems. By rejecting the notion that financial statements compiled by special efforts, which bypass or override official accounting

systems, are worth their high cost or constitute progress, Section 1008 has reintroduced an appropriate sense of proportion.

DoD Financial Management Initiatives

The initiatives announced by DoD over the past year appear to be highly compatible with the course mandated by Section 1008 and clear indicators of intent to transform DoD financial management, not just tinker with it. In Inspector General reports and testimony over the past several years, we had expressed concerns that the cost of the Chief Financial Officers Act compliance effort was unknown, performance measures were lacking, there was no sense of consistently strong central leadership and there was no assurance that managers would get more useful financial information, even if year-end financial statements eventually received favorable audit opinions. The Department is being responsive to those concerns.

We believe that the effort to establish a comprehensive financial system architecture is a necessary and long overdue step. There are undeniable risks--development of the architecture could take much longer than anticipated, the end product might leave numerous unresolved issues, the cost to implement the architecture might be prohibitively expensive or the DoD might lack the discipline to make system program managers conform to the architecture. The DoD does not have a good track record for deploying large information systems that fully meet user expectations, conform with applicable standards, stay within budget estimates and meet planned schedules. Nevertheless, we are cautiously optimistic. The Department has taken a major step forward by accepting the premise that the financial management improvement effort needs to be treated as a program, with all of the management controls that a very large program should have. Those include a master plan, well defined management accountability, full visibility in the budget, regular performance reporting and robust audit coverage. We believe that the DoD is making a good faith effort to create a strong management structure for the systems improvement effort. We look forward to assisting with timely and useful audit advice, just as we did during the Year 2000 conversion.

Likewise, we welcome the emphasis in the President's Management Initiatives on controlling erroneous payments. The DoD has worked hard to improve the efficiency of its disbursement operations; however, this is

another area where the inadequacy of current systems and delays in fielding replacements are vexing problems. As the Department pursues the goal of greatly improved financial reporting, it must also keep focused on the need for better controls in many facets of its day-to-day finance operations and closely related purchasing activities, such as the use of Government credit cards. Again, these are areas where audit and investigative support are vital. In addition to a steady flow of relevant audit reports, we plan to continue supporting the Department with proactive fraud prevention and detection efforts, as well as aggressive investigation of indications of fraud. To illustrate the fact that those who commit financial crimes against the DoD run considerable risk, I have attached to this statement a list of examples of recently closed Defense Criminal Investigative Service cases on frauds involving the misuse of DoD credit cards.

Again, thank you for soliciting our views on these matters.

Attachment

Examples of Defense Criminal Investigative Service
Cases on Credit Card Fraud

- David M. White pled guilty to placing fraudulent charges against 13 Government credit cards. He was sentenced in U.S. District Court, Panama City, Florida, to 18 months incarceration, \$262,840 in restitution and other fees and 36 months supervised release.
- John L. Henson, Jr., pled guilty to using a Government credit card to buy a television for personal use. He was terminated from DoD employment and sentenced in Federal Court in the Eastern District of Texas to a \$3,000 fine and \$1,400 restitution.
- Lionel G. Green pled guilty to a one count criminal information charging him with theft using a Government credit card. He was sentenced in U.S. District Court, Eastern District of Virginia, to 4 months imprisonment, 4 months home detention, 3 years probation and \$61,465 in restitution and other fees.
- Jerome D. Phillips pled guilty to conspiracy in a fraudulent scheme involving the misuse of a purchase card while assigned to the Joint Staff Supply Service. He was sentenced in U.S. District Court, Eastern District of Virginia, to serve a jail term of 12 months and one day, 24 months probation, and restitution and other fees of \$120,100.
- Johnny L. Bailey, formerly assigned to the Joint Staff Supply Service, pled guilty to conspiracy to defraud the Government using his official purchase card. He was sentenced in U.S. District Court, Eastern District of Virginia, to 2 years probation, restitution and other fees of \$70,100 and 6 months of electronic monitoring.
- Tyrone X. Celey, Sr., pled guilty to bribing Joint Staff Supply Service employees to make credit card purchases from his office supplies company. He was sentenced in U.S. District Court, Eastern District of Virginia, to 27 months of incarceration, 36 months of supervised release, and \$400,200 in restitution and other fees.
- Former Master Sergeant Bobby Gilchrist, also a figure in the Joint Staff Supply Service case, pled guilty to one count of money laundering, bribery and conspiracy. He conspired with contractors to defraud the DoD by accepting cash payments for making both otherwise legitimate and bogus purchases from them, using his and other employees' credit cards. He was sentenced in U.S. District Court, Eastern District of Virginia, to 41 months in prison, 3 years of supervised release, and \$400,300 in restitution and other fees.
- Carla F. Armstrong pled guilty to six counts of theft and other charges related to misuse of her Government credit card. She was sentenced in Federal Court, Southern District of Indiana, to 3 years of supervised probation, including 4 months of home confinement, and \$10,945 in restitution and other fees.

- Tommie Ray Briley pled guilty to stealing Government property by using his official credit card to buy hardware items and selling them to a second party for cash. He was sentenced in U.S. District Court, Eastern District of Texas, to 3 years probation and \$26,378 in restitution and other fees.
- Quintin A. Swann pled guilty to charges related to fraudulent use of his Government credit card while employed in the Office of the Assistant Secretary of the Army (Financial Management and Comptroller). He was sentenced in U.S. District Court, Eastern District of Virginia, to 14 months imprisonment, 3 years of supervised release and \$90,200 in restitution and other fees.
- Susan E. Johnson and James E. Johnson, Navy employees, pled guilty to charges related to the purchase of a motorcycle and other items for their own use, misusing a Government credit card to do so. Susan E. Johnson was sentenced in U.S. District Court, Eastern District of Virginia, to 5 years probation and fines totalling \$1,025. James E. Johnson was sentenced to 6 months home confinement, 3 years probation and \$13,279 in restitution.

Press releases on indictments, convictions, sentences and civil settlements stemming from Defense Criminal Investigative Service cases are available at www.dodig.osd.mil. Many of these cases are joint efforts with other Federal and DoD law enforcement agencies, as explained in the individual press releases, when applicable.